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FM AMEMBASSY RANGOON
TO RUEHC/SECSTATE WASHDC IMMEDIATE 7371
INFO RUCNASE/ASEAN MEMBER COLLECTIVE
RUEHBY/AMEMBASSY CANBERRA 1040
RUEHBJ/AMEMBASSY BEIJING 1805
RUEHKA/AMEMBASSY DHAKA 4814
RUEHNE/AMEMBASSY NEW DELHI 4587
RUEHUL/AMEMBASSY SEOUL 8129
RUEHKO/AMEMBASSY TOKYO 5690
RUEHCN/AMCONSUL CHENGDU 1408
RUEHCHI/AMCONSUL CHIANG MAI 1492
RUEHCI/AMCONSUL KOLKATA 0266
RUEAIIA/CIA WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RUEKJCS/DIA WASHDC
RUEHGV/USMISSION GENEVA 3592
RHEHNSC/NSC WASHDC
RUEKJCS/SECDEF WASHDC
RUEKJCS/Joint STAFF WASHDC
RUCNDT/USMISSION USUN NEW YORK 1444
RUEHBS/USEU BRUSSELS

C O N F I D E N T I A L SECTION 01 OF 03 RANGOON 000253

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STATE FOR EAP/MLS; INR/EAP; OES FOR JMIOTKE AND ACOVINGTON;
EAP FOR JYAMAMOTO; EEB FOR TSAEGER
PACOM FOR FPA;
TREASURY FOR OASIA:SCHUN

E.O. 12958: DECL: 09/21/2016

TAGS: [ECON](#) [ENRG](#) [PGOV](#) [EPET](#) [SENV](#) [BM](#)

SUBJECT: BURMESE TAX ISSUES DELAY SHWE GAS SALES

REF: A. RANGOON 156

[¶](#)B. RANGOON 003
[¶](#)C. RANGOON 222

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Classified By: Economic Officer Samantha A. Carl-Yoder for Reasons 1.4
(b and d)

[¶](#)11. (C) Summary. According to company officials, Daewoo remains committed to selling Shwe gas to PetroChina and could finalize a sales contract within the next two months. However, the Burmese Government's recent demands that Daewoo pay additional taxes - up to 10 percent more on production revenues - has put the final memorandum of understanding with PetroChina on hold. Daewoo continues to negotiate with the Ministry of Energy, and expects to resolve the tax issue and ink the final contract by August. Production and delivery of Shwe Gas should begin by 2012, which will bring in an estimated \$1.8 billion a year for the regime, double its current revenues. By early 2009, China plans to construct two 900-mile pipelines - one for oil and one for gas - that will connect the Bay of Bengal with Kunming. China also plans to build a crude oil port in the Bay of Bengal, which will receive and transport via pipeline crude oil from the Middle East to refineries in southwestern China. End Summary.

Further Delays in Shwe Gas Contract

[¶](#)12. (C) Despite announcements that Daewoo would sell Shwe gas to China (Ref B), Daewoo and PetroChina have yet to ink the final sales contract, Daewoo Principal Process Engineer Andrew Hay confirmed. Daewoo has been negotiating with

PetroChina for more than a year but the two companies have yet to agree on the gas price. Hay denied rumors that there were insufficient reserves for a sale (Ref A), and informed us that the price of the gas will be based on the 2.6 trillion cubic feet of proven probable reserves.

High-ranking officials from Daewoo and PetroChina will meet in four weeks to discuss progress; Daewoo Myanmar Managing Director Dr. Su-Yeong Yang is confident that a final agreement between the two companies will be ready by the end of May.

¶3. (C) Although Daewoo-PetroChina agreement could be ready in a matter of weeks, the GOB's recent demands on Daewoo may further delay the agreement, Hay explained. In January, the Ministry of Energy hinted that because Daewoo would profit handsomely from the Shwe Gas deal, it should pay additional taxes to the Burmese Government. Daewoo officials largely ignored the implications, as the company's production sharing contract (PSC) with the Myanmar Oil and Gas Enterprise (MOGE) clearly laid out its tax burden of 10 percent. Three weeks ago, the Ministry of Energy upped the stakes, demanding that Daewoo and the GOB sign a side letter, requiring Daewoo to pay a tax rate of 20 percent on production profits.

¶4. (C) According to Hay, Dr. Yang told the Minister of Energy that the company would not sign such an agreement. Additionally, he told the Minister that Daewoo would not finalize its sales agreement with PetroChina until the matter was resolved, thereby delaying the GOB's income from the sale of Shwe gas. While Daewoo and the Ministry of Energy continue to negotiate the tax issue, Daewoo officials express confidence that the regime will drop the issue because it wants to collect revenues on Shwe gas sales - estimated at \$1.8 billion per year for thirty years - as soon as possible.

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Speedy Delivery...Or Not

¶5. (C) Assuming that Daewoo and PetroChina sign the final sales agreement by August 2008, the earliest Daewoo could begin production and delivery of gas would be 2012, Daewoo Drilling Manager Bruce Leech declared. The company has sorted out many of its previous problems, including the lack of a rig for oil well drilling (Ref B), and can begin design and construction after the monsoon season ends in October/November 2008. Successful delivery depends on whether the Chinese can construct the gas pipeline in time, Leech explained. Hay noted that while PetroChina has yet to sign the official MOU with the GOB for construction of the 900-mile pipeline from Ramri Island to Kunming, contractors have begun surveying Burma's topography to determine where to place the pipeline. Additionally, PetroChina has decided to use spiral pipe, which is cheaper to produce but less solid than seamless pipe, for the underground pipeline. PetroChina remains committed to spending only \$1 billion to build the pipeline and may cut corners to maintain its budget, Leech opined.

¶6. (C) PetroChina plans to construct the pipeline - which will span remote areas including mountainous terrain and jungle - within two years. Daewoo officials are skeptical, calculating that it will take closer to three years to complete the onshore and offshore pipelines and perfect the delivery systems. PetroChina's decision to use low quality materials for the pipeline may be problematic and speedy construction coupled with shoddy materials could create future delivery problems, Hay explained. Spiral pipes tend to leak and are difficult to maintain. However, the Chinese appear to be more focused on getting the job done quickly and cheaply rather than doing it well. It may come back to haunt them, he predicted.

China Interested in Oil

¶ 7. (C) The Chinese are interested in more than just purchasing Shwe gas, Leech commented. China relies on imported oil from the Middle East, which must be shipped through the Straits of Malacca, costing time and money. According to Daewoo officials, the Chinese, who want a quicker, more secure way to obtain oil, plan to build a crude oil port on Burma's Made Island in the Bay of Bengal in 2009.

Instead of making the long journey to China (approximately 16 days travel from the Port of Rangoon), tankers from the Middle East will be able to dock at this deep water port on the Made River and unload oil. At the same time as it is building both the port and the natural gas pipeline, PetroChina will construct a 24-inch diameter oil pipeline, which will connect the oil port to refineries in southwestern China. PetroChina, which plans to spend an estimated \$2 billion on both the port and the oil pipeline, expects to complete the job by 2011. Hay mentioned that PetroChina is looking for a Burmese partner for the port construction project. Embassy sources tell us that the GOB has encouraged the Chinese to partner with Steven Law's Asia World for all pipeline-related construction projects (Ref C).

Comment

¶ 8. (C) While Daewoo officials may be correct in thinking that the regime's desire for increased revenues will overcome its demand that the company pay more taxes, this is not the

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first time the GOB has placed unfair tax burdens on foreign investors. Several other companies, including Canadian mining company Ivanhoe, refused to pay additional taxes, but either caved when the GOB stopped issuing licenses or chose to divest. The regime's contradictory behavior - encouraging Daewoo to finalize its sales agreement while undermining final approval with unrealistic demands for increased tax revenue - shows the erratic policymaking environment that investors must handle. Regardless of the outcome of Daewoo's negotiations with the Ministry of Energy, one thing remains clear: the earliest the regime will get its hands on Shwe gas revenues is 2012. Another potential problem we have heard is that the forced relocation of villagers from the pipeline route could increase the likelihood of sabotage against the pipeline. A poor quality pipeline makes that all the more likely.

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